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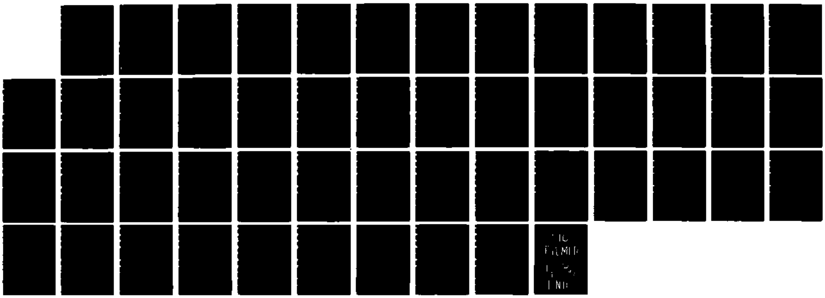

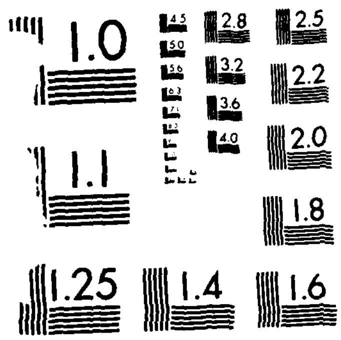
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This study examines the status of the economy of Malaysia to determine whether it qualifies as being a Newly Industrializing Country (NIC). It concludes that Malaysia does not qualify as a NIC because the country's primary sources of export earning come from agricultural commodities and minerals. The growth rate of the economy has now become inadequate to propel the country much further toward NIC status.

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MALAYSIA, A MODEST MIRACLE:
IS IT ABOUT TO BECOME A NIC?

by

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"The views expressed in this article are those of the [illegible] Department of Defense or the U.S. Government."

SCOPE NOTE

The Problem

This study examines, the status of the economy of Malaysia to determine whether it qualifies as being a Newly Industrializing Country (NIC). The study defines a NIC using the four Asian NICs as a benchmark, against which Malaysia is compared.

The study poses these questions:

* What are the characteristics that qualify a developing country as a NIC?

* Has Malaysia reached that state of development or do its development plans move it decisively toward that goal?

* Do external and internal factors facilitate or inhibit Malaysia's movement toward NIC status?

Definitional Note

It is important to distinguish between two Malaysias. Peninsular Malaysia (the nine princely states and Penang and Malacca) and the two states on Borneo, Sabah and Sarawak. Peninsula Malaysia or western Malaysia, has an advanced economy which is at least nearing, the status of a Newly Industrializing Country (NIC). The eastern Malaysian states are backward having little industrialization or infra-structure. This paper focuses primarily on the situation in peninsular Malaysia. The assessment, however, takes all thirteen states into account.

Terms can be a bit of a problem. "Malay" is used to describe the mostly muslim native population of peninsular Malaysia. "Malaya" is used to describe the colonial entity and the Federation after its independence in 1957. "Malaysia" is used to describe the present nation state. "Malaysian" is used to describe a citizen of the state of Malaysia.

The currency figures are quoted as given in the source. If converted, they were converted at the rate prevailing at the time. The 2 December, 1985 Hong Kong spot rate for the Malaysian dollar was M$2.422 to US$1.

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KEY JUDGEMENTS

Malaysia does not qualify as a NIC because the country's primary sources of export earnings (44%) come from agricultural commodities and minerals.(1) Singapore, -- a leading Asian NIC -- also depends heavily on minerals and agriculture for its export income, but its mineral export statistics are inflated by tin smuggled in from Thailand and Malaysia in response to production and export restrictions imposed by those governments.(2)

Malaysia's manufacturing as a percentage of merchandise exports is less than 30%, while the figure for each of the other Asian NICs, discounting Singapore, exceeds 85%.(3) The role of manufacturing in the economy is the area of the greatest difference between Malaysia and the other Asian NICs. Until Malaysia can increase the relative role of manufacturing in its merchandise exports and make it the key sector in its GDP, (1985 may mark the first time manufacturing was the largest sector at 19%), Malaysia will not qualify as a NIC.

Most other factors that bear on Malaysia's NIC potential are also negative. While Malaysia pursues a highly promotional industrialization policy, Prime Minister Mahathir's Heavy Industries Corporation development program is excessively ambitious, considering its aim of producing for the local economy. The Malaysian market is simply too small to support these corporations economically.

The dependence of Malaysia's economy on agricultural commodities and minerals for its export earnings makes it highly vulnerable to unstable world commodity markets. At present all of the markets relevant to Malaysia, are either in disarray (oil and tin), near collapse (rubber) or stagnant (timber and pepper). The likelihood for continued weakeness in this essential sector make the official projections for the 1986 budget dubious and may well require a further tightening of the budget.(4)

Malaysia's New Economic Program (NEP) is designed to enhance the role of the <u>bumiputra</u> (defined as "son of the soil," i.e., any poor person, but almost exclusively Malays) in the economy. However, the rules for <u>bumiputra</u> participation have had a severely negative impact on the economy. Corporations have been set up to buy shares in existing enterprises and to hold them for the <u>bumiputras</u>. Others have been created as exclusively <u>bumiputra</u> owned entities. Much of this effort is financed by the government, but the entities are not always completely under governmental control or management. They are inefficient and constitute a drain on the economy which may inhibit industrialization.(5)

The NEP's bumiputra participation scheme limits non-bumiputra Malaysians to 40% of the equity in all but the smallest enterprises. It also restricts non-Malaysian holdings to 30%. The restrictions on who can hold equity are also reflected in hiring practices which reserve at least 30% of the jobs in the manufacturing sector for bumiputras. These requirements inhibit domestic and foreign investment.(6) Should these restrictive policies not be relaxed, Malaysia will have great difficulty attracting venture capital to support the rate of growth needed to attain NIC status.

While Malaysia has sustained a steady growth rate, that rate has now become inadequate to propel the country much further toward NIC status. The present industrialization policy, dependence upon the agricultural and mineral sectors for income, and the detrimental effects of the pro-bumiputra restrictions appear to preclude Malaysia's attainment of NIC status in the near term.

WHAT IS A NIC?

In writing about Newly Industrializing Countries, definitions of what is a NIC presents a problem. In some respects, NIC status is very much like beauty, i.e., it is in the eyes of the beholder. There can be little doubt that Malaysian Prime Minister Mahathir has attainment of NIC status as his goal. He is consciously pursuing policies he believes to be necessary for achieving this aim.(7) It is the government's intention to transform Malaysia into a fully industrialized nation by the turn of the century.(8)

In order to determine whether Malaysia has become, or is in the process of becoming, a NIC, some frame of reference must be used. In this paper, Malaysia will be compared with the four Asian NICs, i.e., South Korea, Taiwan, Hong Kong, and Singapore. Each country has unique features which pertain only to its situation. South Korea is the largest of the Asian NICs with an area of approximately 38,000 sq. mi. as compared with Singapore's area of only 232 sq.mi. Population varies from South Korea's 42 million to Singapore's 2.5 million. These dissimilarities obviously dictate different economic structures. All of the Asian NICs are considered to be free-market economies with at least the external trappings of democracy in place. The economy of each has expanded rapidly during the past 15 - 20 years.

In order to examine economic factors which may be useful in assessing what constitutes a NIC, selected data for each of the four countries are presented in the following tables. Comparable data for Malaysia is included.

In terms of GNP and per capita GNP growth rates, Malaysia's performance is quite comparable to that of the four Asian NICs. (See tables 1 and 2.) As regards the relative shares of manufacturing and agriculture in GNP, Malaysia is still distinctly more agrarian than the other four. (See table 3.) The big difference shows up in the share and composition of foreign trade. (See tables 4 and 5.)

TABLE I

AVERAGE REAL GROWTH OF GNP(9)

	1970-1979	1979-1983
Hong Kong	6.6%	6.9%
South Korea	11.3%	4.4%
Malaysia	5.9%	12.2%
Singapore	6.5%	8.8%
Taiwan	8.2%	6.2%

TABLE II

GNP/GNP PER CAPITA 1979 & 1983

(US Dollars)(10)

	1979	1983	
Hong Kong	11.8B/2.4K	28.2B/5.3K	(GDP)
South Korea	61.5B/1.6K	73.5B/1.9K	
Malaysia	20.2B/1.5K	27.4B/2.0K	
Singapore	8.3B/4.2K	16.3B/5.2K	
Taiwan	26.9B/1.6K	49.9B/2.5K	

TABLE III

MANUFACTURING AND AGRICULTURE AS A PERCENTAGE OF GNP

(1984)(11)

	Manufacturing	Agriculture
Hong Kong	30.7 (GDP 82)	.7 (GDP 82)
South Korea	28.8	13.9
Malaysia	30	23
Singapore	51.9 (GDP)	.9 (GDP)
Taiwan	49.9	7.4

TABLE IV

FOREIGN TRADE AS PERCENTAGE OF GNP(12)

	1979	1984
Hong Kong	160	163.25 (GDP)
South Korea	14	84.4
Malaysia	79	99.6
Singapore	189	306.4
Taiwan	83	101

TABLE V

1984 MERCHANDISE EXPORTS AND COMPOSITION(13)

	EXPORTS (US $ M)	SHARES OF MANUFACTURING	AGRICULTURAL (percentage)	MINERALS
Hong Kong	21,954 (83)	87.8	3.9	.5
South Korea	27,595	94.4	5.2	.4
Malaysia	14,932	28.5	23	21
Singapore	21,837 (83)	46.4	13.5	28.1*
Taiwan	25,122 (83)	93.1	6.9	nil

*represents smuggled tin.

Asian NICs all depend on foreign trade to provide a large percentage of their GNP. Malaysia's economic performance shows this to be the case. However, when you look at what the foreign trade consists of and what percentage each component enjoys, the significant difference between Malaysia and the Asian NICs emerges. Manufacturing constitutes only 28.5% of Malaysia's export earning. Discounting the Singaporean figures, which are skewed by smuggled tin, this is less than one-third the percentage of the closest Asian NIC. This dependence on the historically unreliable prices earned by agricultural commodities and minerals, places Malaysian industrial growth in jeopardy. At present the world market prices for these exports are either stagnant or declining. Malaysian industrialization and budget projections for 1986 were based on estimates of increased income from these sectors.(14) As long as the prices Malaysia receives for its exports are depressed, industrialization will be slowed reducing Malaysia's chances of becoming a NIC. The rest of this paper will be devoted to examining Malaysia's economy and the internal and external factors that may impair the success of Malaysia's effort to become a NIC.

MALAYSIA'S ECONOMY

Even though the country has experienced growth in the manufacturing sector, Malaysia's economy still is dependent upon income from the export of agricultural commodities and minerals. In 1984, Malaysia produced 65% of the world's palm oil. To put that figure in perspective, palm oil now constitutes 17% of the world's fat and oils market. Malaysian palm oil production represents 11% of that market. Malaysia also has a large share of other world commodity markets, e.g., rubber 45%, tin 27%, pepper 17% and pineapples 6%.(15) The role of individual commodities is shifting within the economy. Until the 1960s, tin and rubber constituted the "duo-culture" that accounted for two-thirds of export earnings.

As of January 1985, the Malaysian Treasury drew nearly 25% of its revenues from petroleum, an increase from 7.4% five years ago.(16) Palm oil was the next largest producer of income with production reaching record levels in 1984.(17) Palm oil is very profitable, having enjoyed the largest continued growth rate of any commodity in the period 1970 - 1982.(18) Plantations are converting acreage previously devoted to rubber to growing oil palms.(19)

Rubber still is a major contributor to Malaysia's economy. In 1984, it earned 10% of the foreign receipts. However, it is experiencing soft market conditions, with prices reaching the lowest level of the decade.(20)

Cocoa is a comer in the mix of commodities upon which the Malaysian economy depends. Cultivation of the crop has grown 10 fold since 1974.(21)

Other contributors to the economy are tin and forest products. Recently, tin has been an uncertain performer. Its price on the Malaysian tin market has been low for several years, often sufficiently so to trigger the "must buy" provisions of the International Tin Agreement (ITA). As a result, the buffer stock became filled causing the manager to have to sell the metal at a loss on the London Metal Exchange (LME) in order to buy in Kuala Lumpur.(22) The forestry sector has experienced some difficulty, but still brought in 10.4% of 1984 earnings.(23)

Malaysia's economic future is heavily dependent upon the income from these commodities. In 1984, "...the primary commodity sector...even excluding petroleum and gas, commodities such as rubber, tin, palm oil, pepper, timber, coconut oil, and pineapples pulled in about ...42% of total export earnings."(24) Export earnings contribute more than half of the countries Gross Domestic Product.(25) Given this dependence and the fluctuations inherent in the raw materials market Malaysia has to expect severe swings in its income from this source. The impact is ameliorated by the diversity of commodities exported which can dampened the oscillations, but does not prevent them.

As previously noted, Asian NICs have experienced a sustained expansion in their manufacturing sector. Malaysia's performance in this area has been very good with an average growth rate of 13 - 14% a year for the period 1960 - 1983.(26) In early 1985, it was estimated that manufacturing would reach 19% of the GDP for the year and in all probability become the largest sector of the economy.(27)

Traditionally Malaysia has relied on government policy to improve the manufacturing sector's share of the GNP. The effort started with tariffs and investment incentives designed to encourage import-substitution manufacturing. Also during the 1950s, pioneer-industry laws granted tax holidays for companies that agreed to locate in Malaysia. The next effort was an attempt to expand manufacturing to out-lying regions by using incentives to encourage labor-intensive industry to locate in parts of the country where development lagged. In order to increase the value added of commodity exports, emphasis has been placed on raw material processing such as palm oil refining, saw mills, etc. At the same time Free Trade Zones (FTZs) were established and generous incentives were provided to attract export oriented foreign firms to Malaysia.(28) All of these programs are still extant to some degree. However, a bold new effort to meet Mahathir's stated industrialization goal has recently been launched, two aspects of which will be examined below.

Free Trade Zones Reappraised

Free Trade Zones were established in Malaysia in 1972 to attract foreign manufactures in order to boost that sector of the of the economy. Those attracted tended to be import dependent, footloose firms who could be lured by generous incentives. Malaysia also established Licensed Manufacturing Warehouses (LMW) where raw materials could be imported, processed and exported duty free as long as the area where the work was done was bonded. These schemes and industrial estates provided 45% of the manufacturing employment in Malaysia.(29) As of 1982, FTZs contributed 51% of manufactured exports and LMWs added another 10% or US$1.58 billion out of a total of US$3.09 billion.(30) The World Bank said in 1982, "More than any other Asian developing nation establishing export processing zones, Malaysia has succeeded in attracting large amounts of foreign investment in to the FTZs."(31) However, the FTZ concept is being reconsidered. Of particular concern is the lack of forward and backward linkages with the local economy. Some the firms in the FTZs have been cutting back on employment, e.g., 2,000 of the 66,000 employees in Penang state have lost their jobs. Others have taken a 20% reduction in wages.(32) Efforts are being made to ensure a better return to Malaysia from the FTZs, such as better control of planning, ensuring that the zones are viable where they are located, and more integration into the local economy.(33)

<u>The Heavy Industries Corporation</u>

In contrast to the FTZ policy of attracting export-dependent light industries is a newly developed plan designed to propel Malaysia into the ranks of the fully industrialized nations. The Heavy Industries Corporation of Malaysia in an ambitious effort to develop a heavy manufacturing infra-structure in Malaysia.

It contains the following projects: Kedah cement,already in production; a hot-rolling steel plant for Sabah; a large sponge iron plant in Trengganu scheduled to come on line this year; the small engine projects, three joint ventures, one each with Suzuki, Honda, and Yamaha; an associated aluminium die-casting plant; "the national automobile" (the Proton) which is supposed to enter production this year; and a heavy engineering complex.(34)

Kedah cement is already on-line. However, there are sufficiently large surpluses of cement in the region that the government has had to impose a 50% tariff on imports to protect the new industry.(35)

The output of all these efforts is destined for use in the domestic market. However, Hicom's planning has not always been well thought out. The hot-rolling steel mill was originally designed to have an economic minimum annual volume of 1,000,000 tonnes. At present, Malaysia's consumption does not exceed 500,000 tonnes annually.(36)

The sponge iron plant in Trengganu is a joint venture with six Japanese firms. Hicom retains 51% control. The facility is destined to produce 600,000 tonnes of sponge iron and billets.(37)

The small engine works is destined to turn out 373,000 100cc motorcycle engines and 30,000 200cc general purpose engines. The aluminium die casting plant is to turn out parts for this project.(38)

The star in this array is the national automobile. The Prime Minister takes great personal interest in all aspects of Hicom, but this is his particular favorite. The car is to be a front wheel drive four door sedan with a choice of either a 1300 or 1500cc engine. It is to be assembled in a joint venture with Mitsubishi. An assembly plant designed to produce 120,000 cars a year is being constructed in an industrial estate near Kuala Lumpur. Also to be constructed are a body-stamping plant, a paint shop, and an engineering complex. Production started this year with the initial run of 5,000 to be made from completely knocked down (CKD) kits, as all cars assembled in Malaysia by foreign importers have been. Tariffs have effectively precluded the importation of assembled cars for the domestic market. As the various support facilities come *on line*, the tariff on the CKDs used to build the Proton will be reduced as domestic content increases. Annual production is forecast to grow to 40,000 units by 1986. Various projections show the Proton providing up to 100,000 - 120,000 vehicles in 1994 against a projected demand of 167,000 to 245,000 cars in the domestic market.(39)

Collocated with the developing auto facility is to be a heavy-engineering complex. Drawing on Swiss, Japanese, and possibily German technical expertise, a complex with 8,000 tonnes casting and 27,000 tonnes forging capacity is to be in operation by 1987. The plant will make cylinder blocks, fly wheels, and a variety of gears.(40)

The overall industrialization effort will be exceedingly costly. As a result of a softness in raw material export prices, continuing deficits in current accounts balances and uncertain markets and financing, Hicom has had to retrench. Plans for a steel cold-rolling mill, an alloy die-casting plant, a pulp and paper mill, and a copper smelting and alloy semi-finished plant have been dropped from the Hicom program.(41)

Cost of the entire Hicom scheme are difficult to determine. A 1983 World Bank estimate put the total cost in the M$6-8 billion range.(42) A recent estimate of the cost of the cement, sponge iron, steel, and car plant is put at M$2.6 billion (US$1.04 billion).(43)

It is apparent that Prime Minister Mahathir has ambitious plans for large scale heavy industrialization in Malaysia. Given the intent not to export any of the products, it is unlikely the relatively small Malaysian market can support profitable operation of these industries.

INTERNAL AND EXTERNAL FACTORS

A country's economic sector does not operate in isolation from other activities. In Malaysia all aspects of life in the country, economic, political, etc., are influenced by the issue of communalism -- ethnic relationships -- which permeates its entire milieu. As of July 1984, Malaysia had a population of 15.3 million, 50% Malay, 36% Chinese, 10% Indians (includes Sinhalese, Pakistanis, etc.) and 4% other.(44)

The problem of communalism is multifaceted, revolving around race, language, religion, culture, and, more importantly, income and wealth distribution. The Malays constitute half of the population, but do not enjoy a similar position in the economy. They resent the position of the relative newcomers, Chinese and Indians, but particularly the Chinese.

The British brought the Chinese to Malaya in the late 19th Century, primarily to work the tin mines. The Chinese displayed their traditional propensity toward business and established themselves throughout the economy. In 1970, the Chinese owned 92.2% of the non-corporate industrial sector (mining, manufacturing, and construction).(45) The Indians were brought in to work on rubber plantations and to fill jobs in the lower levels of the colonial administration.

British colonial administration had been very paternalistic and protective of the Malays and their customs. The independence constitution of 1957 provided special protection for the Malays and preserved a dominate place for the Malay culture. Malaysia was established in 1963 and continued to preserve special legal considerations for the Malays and their culture. The riots of 1969 led to the promulgation of the New Economic Policy (NEP) in 1970 which is now a primary, if not the dominate, fact of economic life in Malaysia today. Virtually all decisions bearing on any aspect of the economy must take NEP goals into account.

The goals to be achieved by 1990 are:

- eradication of poverty among all races by redistribution of wealth and increasing the size of the economy.
- guarantee of the bumiputra's place in society by insuring them
  - -- 30% of equity capital holding
  - -- 30% of the jobs in the manufacturing sector
- limitation of foreign holdings to 30%.

These goals have remained in place and are being implemented by a series of five year plans. In order to insure the attainment of the goal of 30% share capital ownership, a number of semi-governmental entities (referred to as Off Budget Agencies (OBAs)) have been established to buy and hold shares or to acquire or create whole corporations for the bumiputras. Often these purchases are buy-outs of foreign holdings or the creation of purely bumiputra entities such as PETRONAS the state owned oil company.

The Industrial Corporation Act (ICA) of 1975 has, in effect, created a requirement that any firm having more than 25 employees or an annual income of over M$250,000 (US$100,400) must meet the 30% criteria for Malaysian participation. A recent world bank study criticized ICA licensing practice saying, "Objectives concerning ethnic and/or national composition of the workforce and capital stock are best dealt with by incentives."(46)

Foreign buy-outs have been concentrated in export oriented agriculture, primarily British owned plantations, and associated industries. Major companies such as Sime Darby and Harrison's Malaysian Plantations have been brought under the control of Malaysians through government intervention.(47)

A disturbing side effect of the 30% criteria has been to limit foreign investment. Foreign investors are scared-off by the bumiputra participation rules. Those affected may turn to Malaysia's ASEAN partners whose rules governing local participation are much less complicated that are those in place in Malaysia.(48)

Locally the ICA restriction have inhibited the growth of small-scale enterprises (SSEs). Many of these are small speciality machine shops and foundries developed, often by Chinese, to support rubber, palm oil, mining, etc. The manufacturing sector has grown rapidly, 13 - 14% during 1960 - 1983. However, the SSEs have gone against that trend, becoming less productive during the last fifteen years, at least partially due to the NEP bumiputra requirements. This sector is being ignored in industrial planning even though a 1982 World Bank report points out the need to develop an automobile replacement parts industry, which could be an area where the skills and expertise of the SSEs might contribute.(49)

Planning is underway to change the ICA threshold levels for non-bumiputra companies. It is hoped the changes will increase foreign investment and encourage expansion of small companies presently operating in Malaysia.(50) Other steps, recently announced, aimed at easing NEP restrictions are a 5% tax break to SSEs coupled with a second 5% tax abatement to be granted if they do meet the 30% bumiputra participation levels.(51)

How does the NEP impact on communal relations? It was designed to improve the status of the mostly Malay bumiputras while increasing the entire economy of Malaysia. The program has had some successes, but there are problems. Redistribution has not been completely successful. There is a potential for frustration on the part of the poor rural Malay as the gap between his life style and that of his urban middle class counter part grows. Malaysian society traditionally has been hierarchical, with loyalties flowing upward within racial groups. If the disparity within races becomes too great the hierarchical relationships may breakdown and with groupings along class lines materializing. Should this occur a reordering of the political system would be almost inevitable.(52)

The present day political system in Malaysia reflects and is reflective of the communal situation. The ruling party is not a party, but a coalition of various parties, called the "National Front." The Front evolved from the old Alliance after the 1969 riots by coopting various small opposition parties. The three major partners are the United Malays National Organization (UMNO), the Malaysian Chinese

Association (MCA), and the Malaysian Indian Congress (MIC) who formed the Alliance prior to independence to prove to the British that the three races could cooperate. This association has worked fairly well over time. The Alliance and its successor staked out a middle position in the Malaysian political spectrum. The only opposition parties to consistantly challenge the National Front are two extremist, racially oriented parties. The Democratic Action Party (DAP) a Chinese socialist party with ties to Singaporian Prime Minister Lee's party. DAP has been strong in Urban areas where there are large groups of Chinese. The other party is the Parti Islam (PAS) which draws its support from rural, poor conservative muslims. As long as the National Front can continue to function by its traditional method of compromise and negotiation among its various elements prior to elections and then present a common platform and slate of candidates to the electorate, it should continue to draw the broad popular support it has enjoyed in each election since its inception in 1955. There have been recent problems which have not split the Front but have strained its harmony and still may have the potential to cause further tension between the three major factions.

The MCA has had a divisive, drawn out leadership struggle which was settled on 24 November with the election of Mr Tan, the challenger to the Front backed candidate.(53) The subsequent collapse of a large, publicly traded corporation, Pan Electric, in which Mr Tan was a key player may reopen the leadership issue in MCA or cause difficulties with the UMNO faction of the Front. Mr Tan's involvement with Pan Electronic involved some very complex, financially unsound maneuvers necessitated by the NEP 30% criteria. Rumors surfaced in Kuala Lumpur to the effect that the bank loans which had shored up Pan Electric's fragile economic structure were called as a result of political pressure due to Tan's successful challenge for MCA leadership. Whether or not this is true, the collapse of Pan Electric will cause a reordering of procedures in both the Singapore and the Kuala Lumpur Stock Exchanges to preclude the types of high risk deals that have been common there. Losses in Kuala Lumpur alone may total US$2.9-5.8 billion.(54) The bigger question is what does this augur for the National Front? The loss of market capitalization will have the immediate effect of alienating losers, and it is bound to have an adverse long term effect of scaring off investors at a time when private sector funds are being sought to support industrialization and economic expansion. Equally important, if the rumor regarding a political motive for Pan Electric's collapse is perceived to be true, there may be problems between the two largest parties in the Front.

The Indians are often the forgotten race in the Malaysian equation. Recently; however, MIC has been expressing concern over whether it is getting its share of the action in the market place. The party leader Samy Vellu has spoken out on the lack of Indians in the civil service.(55) An argument has erupted over MIC plans to gain control of United Asian Bank. Malays, citing the NEP ownership goals, appear to be maneuvering to preclude Indian ownership. Again, the question of the potential for strain among the major components of the Front must be considered.(56)

NEP policies and related issues are not the only factor that my impair Malaysia's ability to meet its industrialization targets. The issue of debts and cash availability also impacts on Malaysia's ability to finance Hicom as well as meeting the other expenses essential to insuring the continuation of previously established programs. Specific concerns are budget deficits, expenses such as government involvement in the OBAs, and a continuing deficit in current account balances.

The 1986 budget announced on 25 October, continues the recent negative trend. Out of a total budget of M$29.56 billion, the red ink is estimated to be M$7.44 billion (25.2%) compared with an 1985 estimate deficit of M$6.75 billion. In the period 1981 - 1985, the deficit totaled M$45.2 billion.(57) Malaysian government debt service charges grew 44.1% to M$5.3 billion in 1984 which equalled 11.9% of total receipts. External debt as a proportion of GNP has grown from 41.5% in 1982 to 51.7% in January 1985.(58) Continued deficits will necessitate tighter controls. Growth in outlays have been modest, 3.7% form 1985 to 1986 and 2.2% from 1984 to 1985. However, estimated increased revenue for 1986 is only only 1.6% which does not match the growth in outlays.(59) The government is attempting to reduce expenditures, e.g., at present one in every 17 Malaysians is on some kind of state payroll. The state is trying to reduce this ratio and rid itself of some of its public enterprises such as the Malaysian Airline, telecommunications, and port services. However, the present liquidity problems and lack of private investor confidence may make the privatization effort something less than a success.(60)

The problem of OBAs needs closer attention. These agencies absorbed M$8 billion in 1985, up from M$6.8 in 1984.

In 1986, they are forecast to absorb M$6 billion which represents 40% of the entire development budget. Not all OBAs are under strict government control. Failure to gain control of these organizations and their costs, could spell long term budget problems.(61)

The other area of considerable concern is the continuing current account deficit. In 1985, it is estimated to be M$5.3 billion. The 1986 deficit is forecast to be $4.2 billion.(62) The deficit has shown a downward trend after peaking in 1982 at M$8.4 billion.(63)

Estimates for 1985 indicate there will be a surplus of M$5.8 billion and a deficit on services accounts of M$11 billion. The biggest single factor in the red ink was in loss of investment income.(64)

The weaknesses in the Malaysian economy may cause further reassessment of the Hicom undertakings, with the possibility of some of the projects being delayed. The inability to bring the budget into balance and the lack of control over the OBAs may cause Malaysia to slow its industrialization effort.

External factors may well play an even larger role in Malaysia's progress. In the 1986 budget, the government estimated a GDP growth rate of 6% as compared with an earlier (1985) estimate of 6.7% and a 1984 projection of 7.6%. Actual

1985 performace is currently estimated at 5.2%.(65) The collapse in commodity prices has caused this shortfall. 1986 will be a critical year. The forecast for 1986 is based on implausible assumptions of increased production of and a relatively stable price for oil as well as virtually unchanged earnings from tin.(66)

Malaysia depends heavily on income from commodities for foreign currency earnings. Since 1978, while the overall economy grew by 60%, agriculture's share declined from 25% to 20%. There is a direct correlation between external demand and world prices on the one hand and economic growth in Malaysia on the other. In 1984, the price of palm oil rose 40%. Other commodities remained relatively stable and the agricultural sector grew 3.9%. The price of palm oil fell during 1985 and the agricultural sector's growth declined to 2.1%.(67) Palm oil remains a major factor in Malaysia even though the price has not recovered from its loss of 60% of value since May.(68)

Oil may be the key to the Malaysia's ability to maintain the growth forecast for 1986. In anticipation of a drop in the price of oil to US$26 a barrel in 1986, a decision was made in November 1985 to raise the amount of oil lifted to 510,000 barrels per day. This represents an 18.6% increase in production, which would have more than offset the revenue loss anticipated as a result of the fall in prices.(69) However, the recent turmoil in OPEC has created a situation where uncertainty over the price of oil is causing the original projections to be questioned. Should estimates of prices falling to US$18 - 20 after the end of the northern hemisphere heating season prove true, the whole 1986 budget could be severly disrupted. Even if prices only fall to US$22 a barrel Malaysia would lose more than M$1.5 billion from anticipated export earnings of M$40.9 billion.(70)

Other sources of export earnings are depressed and may not perform as projected. Tin is an excellent example, earnings of M$1.3 billion are projected while forecasting a modest 1.4% decline in tin's price. The international tin market is in absolute disarray. The benchmark of M$29.50 a kg has collapsed. However, since trading has been suspended in Kuala Lumpur it is impossible to determine how far it has declined. Some limited selling to processors, at M$20-24 a kg, has been reported. This represents a decline of 19 to 33% from the 24 October quotation. 338 gravel pump (placer) mines which were operating in October have closed. Only 28 of 58 dredge operators were working at the end of November.(71) More importantly, the London Metal Exchange has suspended tin trading until the International Tin Council can come up with an accord for handling the present market glut. The producing governments may have to let the market seek its own level, which initially would be much below the recent benchmark. Therefore, the forecast earnings for tin are questionable.(72)

Rubber also is experiencing severe difficulties. Earlier this year, market standard rubber had reached a level above 200 M-S cents a kg (a composite of the two currencies). Subsequently, the price has fallen to 170 M-S cents which is close to the "must buy" level.(73) The tin fiasco has called other international commodity-protection agreements into question. This may impact on rubber. The International Rubber Organization (INRO) may well be the next to buckle. INRO's stockpile is presently 380,000 tonnes against a current limit of 400,000 tonnes. The limit can be raised to 500,000 tonnes, but INRO does not have the funds to support the effort. Given the turmoil in commodity markets, it is doubtful that international bankers will want to risk money on loans secured by stockpiles of a commodity that has the potential to lose most of its value rapidly.(74)

The commodity market situation raises doubts about the accuracy of the estimates upon which the 1986 budget is based. To exacerbate the situation, ASEAN partners, Indonesia and Thailand can produce palm oil rubber and timber products at a lower price than can Malaysia and may make inroads into Malaysia's export markets. Electronics, a major segment of the industries located in the FTZs, is looking to move on, with Thailand being one of the choice relocation sites.(75)

There are at least two other, external factors that would seriously impair any LDC's hopes of moving into NIC status. One is a growing trend toward protectionism in industrialized nations, as exemplified by the just vetoed attempt by the US Congress to impose tariffs on imported textiles. This effort would have adversely affected Malaysia, since textiles are the other major industry in the FTZs.

The other is a possible softness in the world economy. For example, Malaysia is a major supplier of timber products to the US. As long as housing starts are depressed, the price Malaysia receives for its timber products will not improve. Spice prices also have remained stagnant. Until the economies of industrialized nations expand more vigorously and steadily,it will be difficult for LDCs, who depend on expanding markets for their exports, to grow at a rate necessary to attain NIC status.

IS MALAYSIA ABOUT TO BECOME A NIC?

Malaysia's progress toward NIC status has been slow, but steady. A series of industrial policies has produced growth in its GNP and export trade. However, much of the growth in merchandise exports has come from the increased value of commodities. Based on the currently flat or falling prices for most of Malaysia's commodities, continued growth based on the income from that source is questionable.

Industrialization is a desirable and, and to some extent, obtainable goal. One of the steps being taken to improve income from the FTZs may help to attain this goal. Tax breaks for local companies who sell products to FTZ firms may help to increase the linkage between the external and local economies. Plans to provide a tax abatement based on value added should encourage firms to produce for export. However, these steps by themselves will not gain NIC status for Malaysia.

Hicom's heavy industrialization policy seems ill advised. Cement is a surplus product in the Asian market. The auto manufacturing effort is surely too small to be profitable. Local firms have not given proof of ability to produce components of sufficient quality to support an auto industry. Given the relatively small population of Malaysia and the intent not to export the products from Hicom industries, it is unlikely that these industries will help Malaysia achieve NIC status.

In sum, in comparing Malaysian economic performance with Asian NICs, it appears highly unlikely that Malaysia will attain the status of a NIC. The substantial progress that Malysia has made is not likely to be sustained. While the political environment is currently stable, that stability appears to be achieved at the cost of deeply inefficient socio-political policies that exert a retarding impact on the economy. However, the biggest near term problem is commodity prices. The present disarray in the oil and tin markets may be compounded by a collapse in rubber and other sectors which for the moment are only stagnant. If oil, tin, rubber, and lumber all collapse as they have the potential to do, Malaysia may experience a set back which could further impede progress toward becoming a NIC.

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